



SUCCESS STORIES
2016 Ginnie Mae Summit

Mergers & Acquisitions

September 20, 2016



Mergers & Acquisitions

Overview

- **A record number of M&A transactions have been occurring over the last 36 months.**
- **It is important to understand Ginnie Mae’s policies and processes associated with M&A activity.**

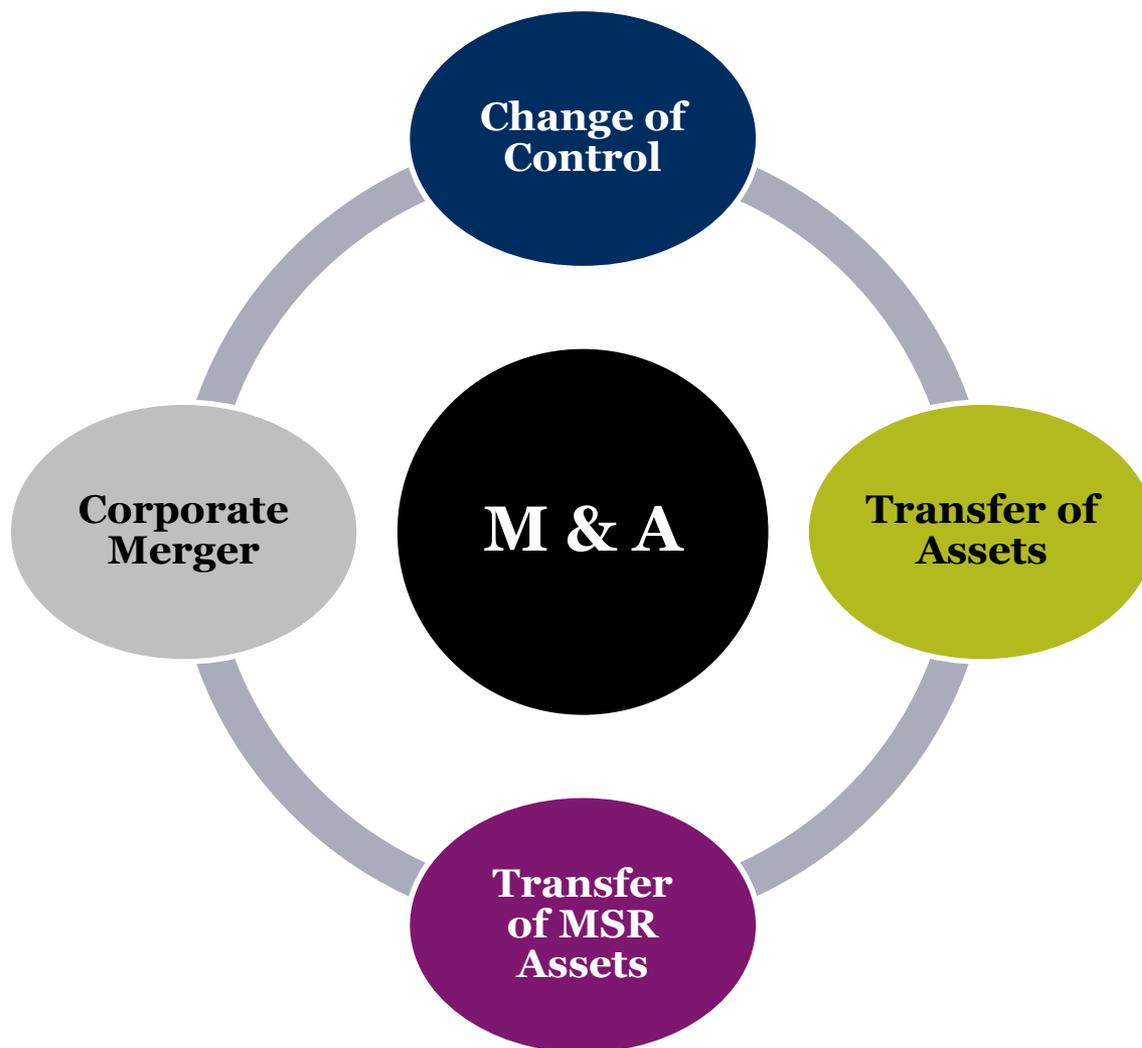
Authority:

- **“Ginnie Mae does not have authority to approve or deny a merger or acquisition but... rather if the entity is approved to continue to participate in the Ginnie Mae program in light of the new organizational change.”**
- **“The Ginnie Mae MBS Guide gives Ginnie Mae the discretion to approve or deny the new merged entity to participate in the Ginnie Mae program after reviewing the consequences of the transaction on the issuer.**

-- HUD OGC Opinion, July 13, 2012



Mergers & Acquisitions: Four Basic Transaction Types



Mergers & Acquisitions: Corporate Merger

- Evidenced by an official Secretary of State merger certificate.
- Documented in MBS Guide Chapter 3-13(B).
- The surviving entity is the key to understanding Ginnie Mae’s requirements.
- Issuer should contact Ginnie Mae as early as possible for confidential pre-review and guidance.
- Actual transfer of securities is a separate operation.

Balance Sheet			
As of December 31, 2011 (000s)			
Assets		Liabilities	
Cash	481	Accounts Payable	625
Marketable Securities	1,346	Current Portion L-T Debt	1,021
Accounts Receivable	1,677	Taxes Payable	36
Inventory	2,936	Accrued Expenses	157
Prepaid Expenses	172	Total Current Liabilities	1,839
Other Current Assets	58		
Total Current Assets	6,670	Long-term Debt	2,332
		Total Liabilities	4,171
Gross Value of Property, Plant & Equipment	2,019	Stockholders Equity	
Accumulated Depreciation	(664)	Common Stock and Paid-in Cap	194
Net Property, Plant, & Equipment	1,355	Retained Earnings	4,009
		Total Shareholders' Equity	4,203
Note Receivable	349		
Total Assets	8,374	Total Liabilities and Equity	8,374

Mergers & Acquisitions: Change of Control

- Purchase of the “right side” of a balance sheet—specifically the equity of the firm.
- Ginnie Mae considers this a Change of Principal Ownership or Control.
- Documented in MBS Guide Chapter 3-13(C).

Balance Sheet			
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Mergers & Acquisitions: Change of Control

Due Diligence / Risk Topics:

- **“Principal Owner” and “control” defined by FAS-57. Must detail org. structure.**
- **If debt financing is used, are leverage and interest ratios reasonable? Otherwise, how is growth funded? (e.g. “just in time capital” poses ops issues)**
- **Is the new owner affiliated with an existing issuer? If so, a Cross Default Agreement is required by CFR. FAS-57 provides context and notes to financial statements provide insights if a relationship exists.**
- **Are the plans of the new owner similar in size and scale to the existing issuer? Small target firms with high growth, PEG ownership require detailed plans.**
- **How will the management team change?**

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Mergers & Acquisitions: Transfer of Non-MSR Assets

- Purchase of the “left side” of a balance sheet—specifically the non-MSR assets used by the business.
- Ginnie Mae considers this a Transfer of Assets.
- Documented in MBS Guide Chapter 3-13(D).

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Mergers & Acquisitions: Transfer of Non-MSR Assets

Due Diligence / Risk Topics:

- **Use of proceeds from Sale.**
 - **Reinvest into company**
 - **Pay down debt**
 - **Distribute proceeds to owners**
- **Is the purchaser a Ginnie Mae issuer, and if so, what are the implications?**
- **Will the company be able to originate and service loans post-transaction? (e.g. loss of a major function)**

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3.1 Mergers & Acquisitions: Transfer of Non-MSR Assets

What types of asset sales would Ginnie Mae be concerned with?

- **Operational assets such as real estate, furniture and fixtures, computer equipment, receivables, short-term investments, etc.**
- **Intangible assets that don't have any physical substance such as trademarks, copyrights, business permits and licenses**

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3.1 Mergers & Acquisitions: Transfer of Non-MSR Assets

Advantages and disadvantages of Asset sales

- **Sellers**
 - **Advantages**
 - **Proceeds may offer cash (liquidity)**
 - **Dispose of unprofitable business lines**
 - **“Right-size” the company to align with resources/new strategy**
 - **Disadvantages**
 - **Taxes on sale of assets**
- **Buyers**
 - **Advantages**
 - **“Step up” depreciable basis of assets**
 - **Avoid transfer of liabilities and associated risks**
 - **Disadvantages**
 - **Difficulty of assignability to buyer**
 - **Unknown contingent liabilities associated with assets**

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3.1 Mergers & Acquisitions: Transfer of Non-MSR Assets

Warning Signs/risks

- **May reduce the operational capabilities of the issuer**
- **Indication of a liquidity crunch**
- **“Fire sale”/Prelude to a bankruptcy or corporate dissolution**
- **Proceeds of sale are distributed to owners instead of reinvested into the company**
- **Departure of key employees**

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Mergers & Acquisitions: Transfer of MSR Assets (Transfer of Issuer Responsibility)

- **Purchase of the “left side” of a balance sheet—specifically the mortgage servicing rights for loans pooled in Ginnie Mae securities.**
- **Ginnie Mae considers this a Transfer of Issuer Responsibility.**
- **Documented in MBS Guide Chapter 21-8.**
- **Key Requirements:**
 - **Must be an approved Ginnie Mae issuer.**
 - **Due diligence will focus on capabilities that are commensurate with the transfer scale.**

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Mergers & Acquisitions: Transfer of MSR Assets (Transfer of Issuer Responsibility)

Due Diligence / Risk Topics:

- **If the sale is the entire portfolio...**
 - **What is the seller's business plan vis-à-vis the Ginnie Mae program?**

- **If the sale is only a portion...**
 - **Seller's loan quality selection bias is always reviewed. (e.g. scale, DQ rates, etc.)**
 - **Appropriate scale to be long-term counterparty.**

- **Buyer considerations...**
 - **Do they have the financial and operational capabilities for the increase?**
 - **Quality of future operational audits. (e.g. growing pains)**
 - **Meets financial and insurance requirements.**

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